■ THE TVA SCANDAL • HOW SAFE IS YOUR PENSION? • AUSTRALIA

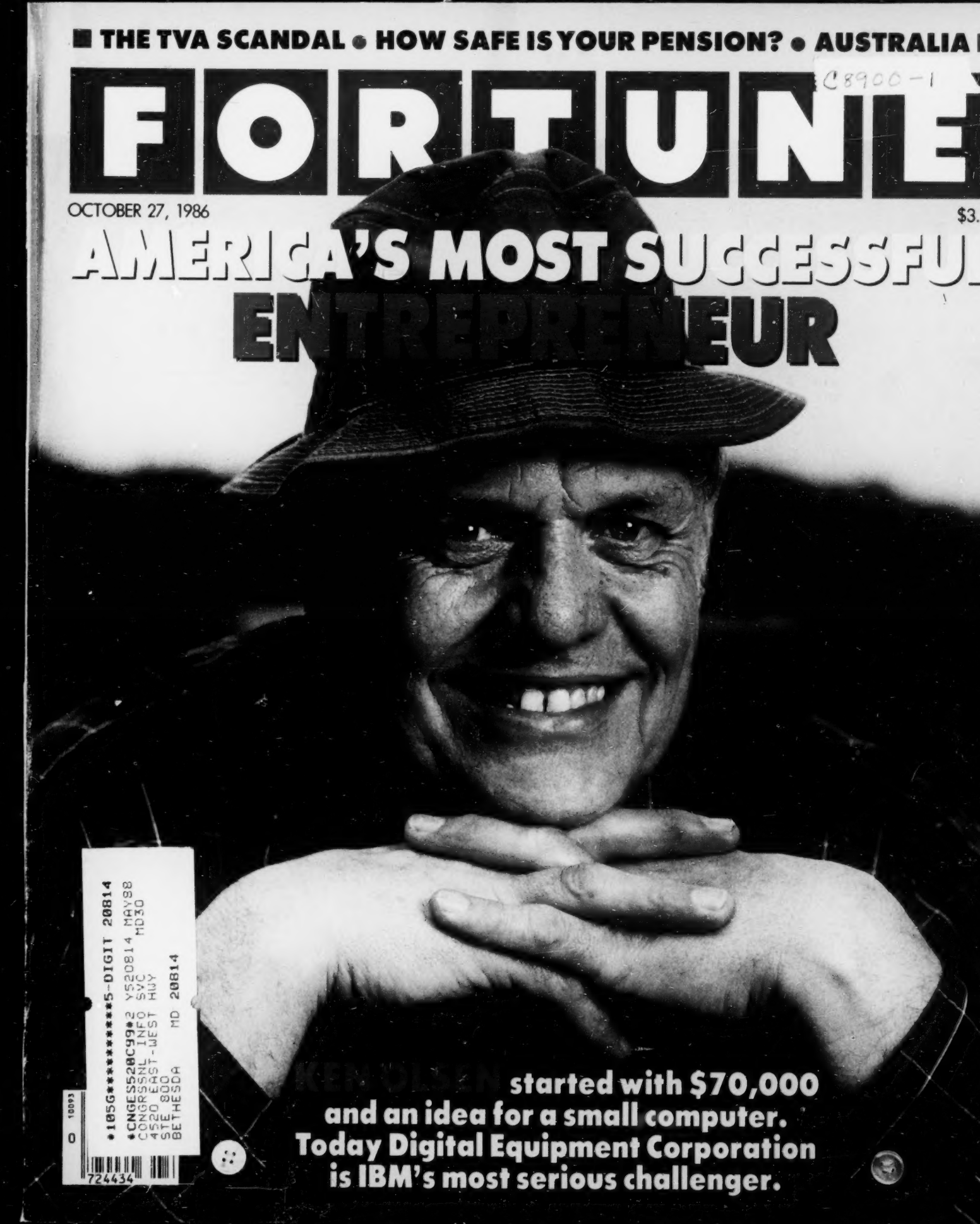
C8900-1

FORTUNE

OCTOBER 27, 1986

$3.

AMERICA'S MOST SUCCESSFUL ENTREPRENEUR



started with $70,000
and an idea for a small computer.
Today Digital Equipment Corporation
is IBM's most serious challenger.

*105G**********5-DIGIT 20814
*CNGES520C99*2 YS20814 MAY88
CONGRSSNL INFO SVC MD30
4520 EAST-WEST HWY
STE 800
BETHESDA MD 20814
0 10093
724434

OCTOBER 27, 1986 VOL. 114, NO. 9

FORTUNE

George Lange photographed Digital Equipment Corp. founder and president Kenneth Olsen in a rare informal portrait at the Sudbury River canoe landing near his home in Massachusetts. *See page 24.*

PROFILE

America's Most Successful Entrepreneur 24
Ken Olsen's DEC changed the way people use computers, and is IBM's most serious challenger. *by Peter Petre*

Some Impressive Also-Rans 29

People to Watch 32

THE ECONOMY

Fortune Forecast:
- **No More Help From the Big Spenders** 35
- **Housing Tops Out** 36

MANAGING

Nuclear Scandal Shakes the TVA 40
The agency hired a hotshot admiral from the nuclear Navy to make its troubled power plants work. Result: TVA is even worse off. *by Brian Dumaine*

EXECUTIVE LIFE

How Safe Is Your Pension? 52
The experts advise managers to worry—a little. *by Patricia O'Toole*

CORPORATE PERFORMANCE

ConAgra's Profits Aren't Chicken Feed 70
The Omaha-based outfit has prospered by reviving food companies others had given up for dead. *by Bill Saporito*

Daimler-Benz Conglomerates 84
In buying three giant high-tech firms, it bought trouble. *by Louis S. Richman*

Caterpillar's Triple Whammy 91
The company finally got the weaker dollar it was calling for—and got clobbered anyway. *by Dexter Hutchins*

Companies to Watch 92

SELLING

The Market Share Fight Over Auto Loans 93

MONEY & MARKETS

The Japanese Want to Be Your Bankers 96
Their pockets are bulging with yen and they are bent on attaining global power—to the chagrin of competitors and the delight of borrowers. *by Gary Hector*

New Yorkers Win a Few in Tokyo 102

POLITICS & POLICY

Coming: The Great Tax Reform of—Yes—1987 105

Is Workfare the Answer? 108
Experimental programs in the states show that it is a good idea. But more work is needed before it is declared national policy. *by Monci Jo Williams*

SPECIAL REPORT

Australia's New Tack 114
With the America's Cup festivities about to start, this seems no time for austerity. But the country is coming to realize it must trim its sails. *by Louis Kraar*

The Cup Runneth Over for Alan Bond 120

The Editor's Desk 4

News/Trends 8
The Big Bang echoes in the New World, Honeywell's computer gambit, Merrill Lynch drops real estate, help for U.S. chipmakers, and more.

Follow-Up 14
Federal Express unzaps, Fiat and Libya break up, Hewlett-Packard's troubles with Risc, and more.

Letters to Fortune 17

Keeping Up 127
by Daniel Seligman

Personal Investing 131
Selling short. A prime hotel stock. Taxable munis.
Portfolio Talk: Bargain hunter Geraldine Weiss

Other Voices 137
Why dollar bashing won't work.
by W. Carl Kester and Timothy A. Luehrman

On Your Own Time 140
Fitness for your kids.
by Marilyn Wellemeyer

Books & Ideas 143
Mr. Walkman talks.
by Irwin Ross

NEWS/TRENDS

Big Bang: U.S. banks hope the shot will be heard

YANK BANKS IN LONDON	TOTAL ASSETS in billions	EMPLOYEES in London
Citicorp	$193.4	3,000
Chase Manhattan	$90.6	2,480
J.P. Morgan	$72.7	1,350
Bankers Trust	$35.4	710
Security Pacific	$51.8	1,500

These U.S. banks will push hardest into London's deregulated markets. Citicorp, Chase, and Security Pacific bought British brokerages.

■ When the explosion sounds in London on October 27, U.S. banks will have a bit more at stake than scores of rivals from around the world. While wrangling in the newly deregulated financial markets, the Yank banks will be trying to bolster a case for similar unshackling at home.

The Americans see a chance to prepare for, and even speed up, the repeal of Glass-Steagall, the law that prohibits banks from underwriting securities in the U.S. Says David R. Lovejoy, who heads the commercial and investment banking operations for **Security Pacific** in London: "We want to prove to the world that we can act professionally and profitably in a totally unregulated environment, and that Glass-Steagall is wrong."

Nothing stops banks from acting professionally, but profitability is another matter. U.S. investment banks such as **Goldman Sachs** and **Salomon Brothers** have prepared for Big Bang by luring employees with London expertise (salaries have skyrocketed), and the most aggressive U.S. banks have snapped up British firms to teach them the how-tos of trading stocks and underwriting bonds. Security Pacific invested about $100 million in **Hoare Govett**, one of the largest British brokerages. **Citicorp** and **Chase Manhattan** each bought two smaller London houses. Citicorp's $12 billion of capital worldwide, the greatest of any firm in London, will allow it to take risks and sustain losses as it vies for market share.

And losses there will be. Big Bang scraps fixed brokerage commissions, and some industry analysts predict commissions will be cut in half. Underwriters of Eurobonds—securities issued outside the borrower's home country—have never been regulated; they have knocked fees down so low that few are making money. With the number of firms allowed to trade British government bonds swollen from six to 27, some players will surely drop out of that market. **Bank of America** already has.

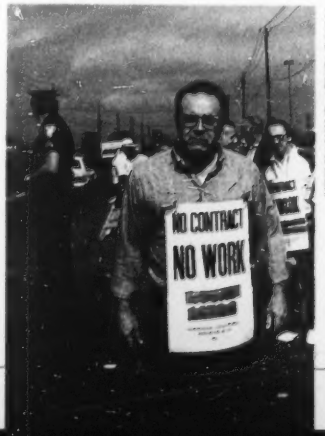
Investment bankers note that U.S. commercial banks have little experience in underwriting securities. "They're starting from scratch," says one. Citicorp, Security Pacific, and Chase probably have the capital—and with their acquisitions, the know-how—to do well. Perhaps a dozen other outfits will emerge as successful full-service firms, including several U.S. investment banks, some large British and European banks, and a few Japanese firms. For better or worse, that is as good a model as any for a Wall Street without Glass-Steagall.

STAFF *David Kirkpatrick, Michael Rogers, Patricia Sellers, H. John Steinbreder, and Eleanor Johnson Tracy*

Heavy weather for Northeast ports

■ The International Longshoremen's brief strike against a dozen East Coast ports from Maine to Virginia may cause some shippers to steer clear of those harbors for a long time. Philadelphia, Norfolk, Baltimore, and New York, for instance, might lose valuable cargo and jobs to safer harbors, such as Savannah, Charleston, New Orleans, and even Los Angeles, where strikes are not in prospect.

A longshoreman on strike



Longshoremen on Northeast waterfronts face increasing competition from non-union facilities as well as railroads. A Japanese automaker may find it cheaper to land cars on the West Coast and send them by rail to New York than to ship them directly to the East Coast. Still, the strike has shown that the longshoremen, whose ranks have dwindled with the spread of containerized shipping, remain a formidable force.

Honeywell's way to fight the big guys

■ Computer-industry analysts have been warning that **Honeywell**, with only 2% of the mainframe market, will have to restructure or give up competing with giants **IBM** and **DEC** (see cover story). It looks like the $6.6-billion-a-year electronics and defense company will restructure. It announced it was negotiating to combine its computer business with Japan's **NEC** and France's government-owned **Bull.**

Honeywell has strong ties to both companies, and systems made by all three are largely compatible. France's new conservative regime plans to sell Bull and may be reluctant to shell out cash for a combination. Negotiations will be complex. But Daniel Mandresh, a Merrill Lynch security analyst, says, "It doesn't matter who owns what piece of what. A combination with NEC and Bull will make a stronger computer company."

THE JAPANESE WANT TO BE YOUR BANKERS

Japan's financial giants are bulging with yen and bent on becoming global powerhouses in everything from retail banking to underwriting. They are cutting interest rates and fees—to the chagrin of competitors and the delight of borrowers.

■ *by Gary Hector*

JAPAN'S HUGE financial firms, sitting astride global markets like 300-pound sumo wrestlers, are fast becoming the most potent force in world finance. Their strategy should be familiar to anyone who remembers what happened in cars and stereos. First they demand quality and high productivity from workers. Then they seize on cost advantages, such as the rock-bottom interest rates Japanese banks pay on savings accounts. And finally they produce a less expensive copy of the foreign competitor's product—not manufactured wares this time, but bank loans and the underwriting of securities.

Fed by the fanatic propensity of ordinary Japanese to save and by seemingly unending trade surpluses that need to be recycled abroad, Japan's commercial and investment banks are snatching significant chunks of business in such major financial hubs as London and New York. "The feeling I get," says George Vojta, executive vice president of Bankers Trust New York, "is that the Japanese are taking a lot of new high-volume, low-margin business."

Japanese banks and brokerage firms, minor players in the international finance game a half-dozen years ago, routinely underwrite bond issues in Europe for General Electric, Exxon, and IBM. At U.S. Treasury bond auctions, the Japanese sometimes buy 60% of a new offering. Japanese commercial banks, prone to lend on more favorable terms than American competitors, now hold 8.4% of all commercial loans in the U.S. Thomas Chandos, director of international capital markets at Kleinwort Benson Ltd., London's biggest merchant bank, thinks he knows the shape of

In New York: *Akira Shimizu, president of Nomura Securities' U.S. subsidiary, has a bond operation a-babble with Brooklyn accents.*

the future. "Most of us should expect to see Japan as the dominant influence in the financial markets for the rest of our working lives," he says.

While unnerving to U.S. and European money men, the onslaught has a bright side. Large corporations and local governments, as well as the U.S. Treasury, are borrowing at lower rates than they thought possible. Bright young Americans only a few years out of business school are finding Japanese financial companies eager to hire; those with more experience can demand big starting salaries.

Money is the ammunition in the Japanese financial offensive. In the first seven months of 1986 a record $68 billion poured out of Japan in search of long-term investments. Unlike Arab oil potentates, who recycled most of their trade surpluses in the 1970s through U.S. and European banks, Japanese investors use their own. Early last year Japan became the largest creditor nation in the world even as the U.S. joined the ranks of debtors. By 1995, one Japanese study projects, the rest of the world will owe Japan some $1 trillion.

An elite of global financial powerhouses is likely to emerge over the next decade as computer technology enables the London, New York, and Tokyo financial markets to blend into one. In Japan both commercial and investment banks, separated by law like their U.S. brethren, are jockeying to stay in the top ranks. To do so they must grab even more business from competitors, especially in the U.S., where finance is still dominated by the home team. Says Akira Shimizu, 49, the impeccably tailored president of Nomura's U.S. subsidiary: "Without more U.S. companies as clients, we can't continue to rank high in world markets."

TO SIGN UP clients, the Japanese offer irresistibly cheap services. "They're willing to take losses for ten years in order to build a business," says David Burnett, executive director of London's Orion Royal Bank. Even the most Westernized Japanese bankers disdain U.S. and European notions of an acceptable profit. Yasuhiko Watanabe, 44, senior deputy general manager in London for Mitsubishi Bank, Japan's fourth largest, represents a new generation of internationally sophisticated Japanese bankers. A veteran of six years in New York, he speaks English fluently, sends his oldest child to a U.S. prep school, and occasionally displays a disarming Western candor. But Watanabe's views on profits remain Japanese. "It's dangerous to concentrate only on quick profit," he says. A senior officer of a large Japanese-owned California bank puts it more bluntly: "The Americans are greedy."

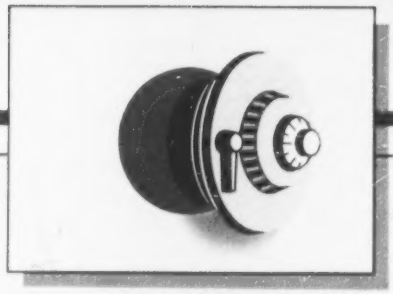
U.S. competitors counter by suggesting the Japanese are "dumping" money, just as they supposedly sometimes sell merchandise below cost to win market share. To a great extent, however, they are merely exploiting some built-in advantages. Japan's commercial banks pay low, government-controlled rates of interest to savers: 3.38% on six-month deposits and a mere 0.38% on passbook accounts. With the government's acquiescence, Japan's securities firms charge high, fixed commissions. That fattens the profits that fuel overseas ventures. Buying 100 shares of a $50 stock costs a Japanese investor $63 in fees, while in the U.S. a discount broker would charge far less.

The Japanese government has dismantled some financial regulations in ways that created new business opportunities for Japanese firms. In 1984, under pressure from the Reagan Administration, Japan relaxed restrictions on yen loans to foreigners. Since then borrowers have created an $18-billion-a-year business in yen-denominated bonds centered in London but dominated by Japanese firms. Shimizu of Nomura says: "This gives us a chance to make a breakthrough in doing business with U.S. firms."

The securities firms are the pacesetters in Japan's global drive. The most fearsome is Nomura, which earned an estimated $3-billion pretax profit in the past 12 months. So colossal is Nomura that its market capitalization, or what the stock market says all its shares are worth, is ten times that of Merrill Lynch. In a takeover financed with stock, Nomura could swallow Merrill Lynch like a bit of predinner sashimi. Ranking far behind Nomura in terms of shareholders' equity are the securities firms of Nikko, Daiwa, and Yamaichi. But even the smallest of these has more equity than most big-name U.S. investment banks.

The big Japanese securities houses have led an assault on the Eurobond market, where borrowers raised $137 billion last year, far more than was floated in the U.S.

REPORTER ASSOCIATE *Alison Bruce Rea*



JAVIER ROMERO

Japan's Rising Financial Prominence

Seven of the world's biggest commercial banks and four of the top investment firms are Japanese. Dai-Ichi Kangyo toppled Citicorp as No. 1 commercial bank with a little help from the muscular yen.

COMMERCIAL BANK	ASSETS IN BILLIONS*
Dai-Ichi Kangyo† JAPAN	$190.0
Citicorp USA	$173.6
Fuji JAPAN	$170.3
Sumitomo JAPAN	$164.9
Mitsubishi JAPAN	$161.5
Sanwa† JAPAN	$150.0
Norinchukin† JAPAN	$136.9
Industrial Bank of Japan† JAPAN	$125.7
Banque Nationale de Paris FRANCE	$123.1
Crédit Agricole FRANCE	$122.9

INVESTMENT BANK	EQUITY IN BILLIONS*
Nomura Securities† JAPAN	$3.4
Merrill Lynch USA	$2.3
Nikko Securities† JAPAN	$2.1
Daiwa Securities† JAPAN	$2.0
Salomon Brothers USA	$1.7
Yamaichi Securities† JAPAN	$1.6
Shearson Lehman Brothers USA	$1.2
Prudential-Bache Securities USA	$1.0
Dean Witter Financial Services USA	$0.9
Goldman Sachs USA	$0.9

*Japanese banks as of 3/31/86, Goldman Sachs as of 11/30/85, all others as of 12/31/85. †Excludes subsidiaries.
SOURCE: IBCA BANKING ANALYSIS LTD. (LONDON), SECURITIES INDUSTRY ASSOCIATION, AND COMPANY REPORTS

corporate bond market. Just five years ago there was scarcely a Japanese name among the top underwriters of Eurobonds. Now five Japanese firms rank in the top 20, with Nomura, Daiwa, and Nikko among the top ten. According to *IFR International Financial Review*, a British publication, Japanese securities firms, together with commercial banks, are lead underwriters for about 22% of all Eurobond offerings these days. Only U.S. firms, with a 26% share, play a bigger role.

The Japanese are underwriting bonds at such extremely low prices, competitors argue, that others are finding it harder and harder to make money. The Japanese are not the only ones accused of cutthroat practices; last year the Union Bank of Switzerland drew the same kind of criticism. But the Japanese are a special case because they have so much of the business. Many Japanese firms, obsessed with moving up to a higher position in the rankings of top Eurobond underwriters, are more interested in the sheer volume of deals than in profits. "The problem for non-Japanese firms is whether you should join in the competition for rankings with them," says Andrew Large, chief executive of Swiss Bank Corp. International in London.

DAVID GAMBLE

In London: *Mitsubishi Bank's Watanabe pushes Eurobond deals.*

The most common tactic of the Japanese is underwriting bonds with below-market interest rates. A $300-million Eurobond offering by General Electric in May, for instance, was priced to yield 7% even though a similar GE bond was trading at a yield of more than 7.2%. In this case Yamaichi, the underwriter, may have got burned because the bonds proved hard to sell in the Euromarket.

Marketing, or "stuffing," power enables the Japanese to offer low underwriting commissions and interest rates to borrowers. With their vast retail networks in Japan, the securities firms can shove billions of dollars of bonds into the hands of small investors. Interest rates that look low in the highly competitive international market may look dandy in Sapporo or Osaka.

So formidable is this sales network that the Japanese may be abusing their power. Competitors say they regularly form syndicates with U.S. and European underwriters even though, in effect, they have presold all the securities to Japanese clients. There is nothing illegal about such a practice, which lets the Japanese give the impression they are part of the club and allows other members of the syndicate to collect underwriting fees for doing nothing but putting their names on tombstone ads. But the charade can mislead investors, who expect a broadly underwritten deal to have a big secondary market. A trade group of Euromarket underwriters, the International Primary Market Association, has urged its members not to participate in such bogus syndicates. While the practice may have diminished, scarcely anyone expects it to stop.

Whatever the complaints, the Japanese financial assault has been wildly successful. With chief financial officers looking increasingly at price rather than the long-term relationships with investment banks that once were the norm, the Japanese could build up a tremendous volume of business. Says a senior official of a major British bank, who obviously laments the decline of lasting relationships: "Now that it is a whore's market, outsiders can easily gain market share."

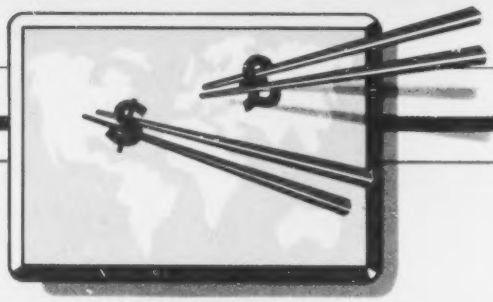
Eurobond dealers aren't the only ones hearing footsteps. All four of Japan's major securities firms are rushing to become primary dealers in U.S. government securities, who buy them at Treasury auctions for resale to other dealers. In the past year each of Japan's big four has lured away talented traders from U.S. firms by paying huge salaries and bonuses. The atmosphere in these Wall Street trading rooms is decidedly American, with Asian faces in the minority, and a typically unruly crowd of traders more likely to shout out orders in Brooklynese than Japanese.

Nomura has beefed up its U.S. trading staff this year from 32 to 52. Daiwa, also expanding, recently opened a corporate bond trading operation. Both Nikko and Yamaichi are bulging with new traders. And the trading teams are doing immense amounts of business: In the second quarter they handled $71 billion in U.S. Treasury bonds and notes alone.

Profits, again, may be scanty, but the Japanese are willing to pay for the entrée. Says Toshio Mori, 53, chairman of Nikko Securities' New York subsidiary, "For the time being, as long as the income is enough to offset the operating cost, I'm satisfied."

JAPAN'S COMMERCIAL banks, though somewhat less fired-up than the securities firms, are also scurrying around the globe for customers. Because of their country's enormous trade surpluses, the banks are loaded with money to lend. They have picked up big market shares in U.S. and European commercial lending, particularly where low interest rates are more important than innovation. Mitsubishi Bank, for example, beat out American competitors with an aggressive bid for a $500-million loan to NWA Inc., the parent of Northwest Airlines, to finance the purchase of Republic Airlines. "They beat us on price," says an executive of a bank that lost out.

continued



Within the past six months many Japanese banks have also been buying floating-rate notes in Europe and commercial loans from banks in the U.S. Still saddled with big loans to Latin American governments, the Japanese have been avoiding risky or relatively unknown borrowers. But that appears to be changing. In the past few months they have started to lend on U.S. leveraged buyout deals, including those involving Beatrice Cos., Safeway, and Macy's.

The banks have moved in on another niche: insuring U.S. municipal bonds. For a fee the big Japanese banks, most of which are AAA-rated, guarantee the repayment of debt by a state or local government, in effect passing on their higher credit rating to the municipal bond. The borrower pays a lower interest rate. At times the Japanese earn less than one-tenth of a percentage point for this service, or less than half what a U.S. bank might consider minimally profitable. Last year the Japanese wrote such guarantees on $18 billion of new muni bonds, nearly half the total insured and 72% of the volume done by foreign banks.

The Japanese are becoming big players in U.S. retail banking. Their biggest beachhead is in California, where they own five of the 11 largest banks. "By the early 1990s there may be as few as 30 nationwide banks that will control 50% of all deposits in the U.S.," says Duane Hansen, managing director of worldwide financial services for the Arthur Andersen accounting firm. "Four to six of those could well be foreign, probably Japanese."

Profits growth has slowed at the big banks, partly because they are beginning to have trouble lending all their money. This is forcing them to alter long-term strategies. The clearest evidence was Sumitomo Bank's decision to buy a $500-million stake in Goldman Sachs, one of Wall Street's premier investment banks. Apparently Sumitomo believes it can't stay competitive in the U.S. without developing skills as an investment banker. Sumitomo gets no voice in management, just a claim on a paltry 12.5% of Goldman's future profits. But outsiders assume the Japanese are taking their traditionally long view. Sumitomo could easily demand a say—and more of the profits—later on.

Not everyone is convinced that the Japanese juggernaut will keep rolling. Critics note that while the overseas offices of Japanese firms are staffed with a few polished, sophisticated executives, the hallways are filled with chain-smoking Japanese-speaking specialists wearing dark-blue polyester suits. Language and culture remain a problem in many business dealings. "They have

INSTITUTION	TRANSACTION
Mitsubishi Bank LENDER	$500-million loan to parent of Northwest Airlines to finance acquisition of Republic Airlines
Nomura Securities LEAD UNDERWRITER	$479.4-million Euroyen offering by Canadian government
Daiwa Securities LEAD UNDERWRITER	$300-million Eurobond offering by General Electric
Nikko Securities LEAD UNDERWRITER	$250-million Eurobond offering by Exxon Credit Corp.
Long-Term Credit Bank of Japan LEAD UNDERWRITER	$200-million Eurobond offering by PepsiCo
Nomura Securities LEAD UNDERWRITER	$200-million Eurobond offering by IBM Credit Corp.
Nomura Securities LEAD UNDERWRITER	$200-million Eurobond offering by General Motors Acceptance Corp.

SOURCE SECURITIES DATA CO. INC., OTHER SOURCES

Choice Deals With an Asian Flavor

Over the past eight months, as this sampler shows, a blue-ribbon roster of North American clients have turned to the Japanese. General Electric, a repeat customer, has raised a total of $1.2 billion.

NEW YORKERS WIN A FEW IN TOKYO

■ Cracking the Tokyo financial markets has been tough for Western firms. "Sisyphus had it easy," says Brian Waterhouse, a financial analyst in Tokyo for the British brokerage house of James Capel, referring to the mythological king doomed to push uphill a boulder that kept rolling back. But two U.S. institutions, Salomon Brothers and Bankers Trust New York, have grabbed impressive slices of business. Local talent and connections have made the difference.

Salomon, an old hand at yen bonds outside Japan, opened its Tokyo office in 1982. The best way to make money on securities inside Japan, it decided, was to use top Japanese traders. Salomon recruited Shigeru Myojin from Yamaichi Securities, a leading brokerage house, and hired bond traders with prior experience at Daiwa, Wako, and other firms. New York gave the Tokyo office enough capital to take huge positions in the market. The strategy worked. In the special niche of bond futures trading, Salomon now ranks among the top three brokerage houses in Japan, the only Western outfit in such fast company.

With the help of a powerful partner, Bankers Trust has grabbed $770 million in Japanese pension assets and corporate funds—more than half the business garnered by all foreign firms combined. Most foreign operations have worked closely with Japanese banks and have generally shared local partners with each other. Bankers Trust has had Japan's Sumitomo banking group all to itself, and the partner's role has been limited to introducing Japanese corporate clients to Bankers Trust. Clients are turning up so fast the New York bank plans to add ten more to its Tokyo staff of 20 by next spring.— **Frederick Hiroshi Katayama**

It's true. Chicago and New York do have something in common.

Both Chicago and New York have a Mayfair Regent. With the elegance and poise of a bygone era, both cater to the traveller in search of perfection.

the Mayfair Regent
CHICAGO NEW YORK
A REGENT *INTERNATIONAL HOTEL

AUCKLAND BANGKOK BEVERLY HILLS CHICAGO DUSSELDORF HONG KONG KUALA LUMPUR LONDON MELBOURNE NEW YORK OSAKA SYDNEY

800-545-4000

Fitness Master LT-35

TOTAL SYSTEM FOR CARDIOVASCULAR FITNESS.

Simulates cross-country skiing, regarded by fitness authorities as the top cardiovascular exercise. Rated higher than jogging, swimming, biking or rowing.

- Fluid motion — no jarring impact on bones and joints. Avoids running related injuries.
- Excellent for weight control and body tone.
- Stable, unit rests flat on floor. Lightweight for portability. Weighs only 35 lbs.
- Easily stored. Folds to 5 inch height. Slips under a bed or stands upright in closet.
- 30 day home trial. 2 year warranty.
- Can be used by men and women regardless of size or weight. Height and resistance adjustable.

For a Free Brochure call:
TOLL FREE 1-800-328-8995
In Minnesota 1-612-474-0992
Fitness Master, Incorporated
1387 Park Road Dept. FO
Chanhassen, Minnesota 55317

a real weakness as salesmen," says a Wall Street consultant.

The Japanese have hired a few American and British stars in recent months, such as Stephen Axilrod, formerly Chairman Paul Volcker's top staffer at the Federal Reserve Board, who is now vice chairman of Nikko Securities in New York. But it remains to be seen whether the Japanese can hang on to top-flight non-Japanese talent.

The ability of the Japanese to innovate is still in doubt. "They are excellent copiers and excellent improvers, but not good innovators," says a senior officer at a major New York bank. He hurriedly adds: "This shouldn't lead one to complacency." In a quest for sophistication, the Japanese have hired some of the "rocket scientist" types who have created exotic new trading techniques at Wall Street investment firms. Most Japanese financial houses have been hiring merger and acquisition specialists. But it may take years to catch up. "The real brainpower is still with the American firms," says Rodney Chase, group treasurer of British Petroleum.

DESPITE ALL the money they have to lend, Japanese commercial banks are thinly capitalized. That, along with weak profits, could slow their overseas expansion. IBCA Banking Analysis Ltd., a bank-rating agency in London, considers Japanese banks safe because the government can be counted on to bail them out. But their equity capital is meager by U.S. standards: on average, 2.3% of assets for big banks vs. 4.9% for their U.S. counterparts. A bank cannot prudently allow its deposits and loans to exceed a certain prescribed multiple of stockholders' equity. "If Japanese institutions had amassed shareholders' equity," says Minoru Inouye, president of the Bank of Tokyo, "we'd have dominating power."

Formidable now, the Japanese could become awesome if their government strips away regulatory fetters and lets interest rates rise. Japan's great financial houses would lose the advantage of low interest rates, and foreign firms would get a broader license to hunt for business in Japan. But a recent report by Nomura Research Institute, a think tank supported by Nomura Securities, urged the government to get on with deregulation. Nomura's heavy thinkers, who want the government to flex Japan's financial muscles, believe that under deregulation their country's institutions would come out far, far ahead. F